MEGA

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Michigan House Energy & Technology Committee Members

RE: MEGA Comments – 2008 PA 286 Issues

Dear Committee Members:

The Michigan Electric and Gas Association ("MEGA") appreciates the opportunity to provide comments on PA 286 issues before the Committee. MEGA believes that the reforms in 2008 PA 286 are working as intended and the Michigan Public Service Commission ("MPSC") is able to address specific complaints about rate levels and procedures. MEGA generally supports continuing the 10% retail choice cap or possible abandonment of restructuring as reasonable measures to assure stability in the energy markets and the ability of utilities to finance long-term generating capital investments. Expansion of retail choice will raise old and new issues for the MEGA utilities and the legislature, described below.

MEGA Organization

MEGA is a trade organization of investor-owned gas and electric public utilities serving Michigan. The accompanying slides provide details about these members and a map of their service areas, primarily in the Upper Peninsula and less urban areas of the Lower Peninsula. MEGA works in collaboration with all of the regulated utilities but its policy direction is from the identified members. MEGA electric and gas utilities are regulated by the Michigan Public Service Commission ("MPSC") except that rates for Citizens Gas Fuel Company and Aurora Gas Company are regulated by their local municipalities.

The fully regulated MEGA members are subject to the recent legislative directives of 2000 PA 141 (electric restructuring), 2008 PA 286 (rate setting) and 2008 PA 295 (renewable energy, energy optimization, etc.). These comments focus on Act 286, in particular the choice cap.

Electric Restructuring Background

The centerpiece of Act 141 was the requirement for investor-owned utilities to establish rates, terms and conditions of service that would allow all retail electric customers to choose an alternative supplier ("customer choice"). The vision was a competitive market for electric generation service that would benefit customers by lowering prices, due to the new competitive forces unleashed by this restructuring. Some have suggested that the proponents were aware this choice would not be available for all customers for some time; however, the legislation established a choice education program designed to give public education to all customers, particularly residential customers, to enable them to make an informed decision among competing service offers. The recitals of purpose in Act 141 including the goal of ensuring choice of supplier to all retail electric customers.

Unintended Consequences – Part One

Widespread retail choice did not emerge from Act 141 because alternative energy suppliers targeted their service offerings to select commercial and industrial customers of the largest investor-owned utilities, Detroit Edison and Consumers Energy. Michigan's restructuring program became effective January 1, 2002. By then, the California energy crisis of 2000-2001, the Enron Collapse and rising natural gas prices were impacting the national restructuring movement, leading to a halt in state restructuring efforts and suspension or repeal of restructuring laws in California and other states. The design of Michigan's restructuring program has been questioned as an effective means of introducing competition without negative consequences.[1]

Alternative Electric Supplier ("AES") Participation – MEGA Service Areas

After implementing retail choice as required by law, the MEGA utilities did not experience any significant shift of generation load to AESs during most of the post-2002 period. Marketers had little interest in the residential market anywhere in Michigan, due to factors including lack of economic "headroom" to significantly undercut the utility price and cost of acquiring customers. There were far fewer lucrative opportunities among the C&I classes and the Upper Peninsula has its unique infrastructure and transmission issues. Unlike traditional utilities, AESs have no legal duty to serve any customers who desire their service. Indiana Michigan Power, part of the AEP system and Upper Peninsula Power Company have experienced recent customer migrations to retail choice in small numbers - 120 and 4 customers, respectively in the last year, out of more than 6,800 total C&I AES customers indicated in the MPSC 2012 competition report.

After implementation of retail choice in 2002, it became apparent that AESs were not seeking to serve residential customers, who benefited from the 5% rate cut and subsequent rate freeze in the early 2000s applicable to the largest utilities. The choice education program was suspended by the MPSC when it became apparent that service offerings would be limited to business customers.

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[1] Kimberly L. Savage, Restructuring Michigan's Electric Industry – What's Wrong with Act 141, MSU College of Law (2004) www.law.msu.edu/king/2004/2004_Savage.pdf

MEGA electric utilities did not seek recovery through securitization of assets, unlike DTE Electric and Consumers Energy. There were no stranded assets due to the lack of revenue loss from customer switching. Traditional MPSC cost-of-service regulation continued for these companies; however, at the wholesale level, the development of the Regional Transmission Organization ("RTO") regional dispatch and energy market proceeded. Indiana Michigan (PJM) is the only member not participating in the Midcontinent (formerly "Midwest") ISO (independent system operator).

2008 PA Reforms and Retail Choice Cap

Act 286 was part of an intricate package of energy law reforms that also included new standards for renewable energy and energy optimization and a net metering law in 2008 PA 295. The major regulatory reform items of Act 286 were: 10% retail choice cap; use of projected test year in rate setting; self-implementation of rates 180 days from filing request with MPSC (self-implementation); deemed approval of rates with no MPSC final order in 12 months (12 month stop); new MPSC authority over utility mergers and acquisition of control (merger authority); optional certificate of need ("CON") with pre-approval of cost recovery for new electric plants and phased elimination of inter-class rate subsidies (deskewing). The retail choice cap was instituted due to concerns over financing new plant construction in a market where customers could switch to another generation provider, threatening the stability of cash flow to repay the debt and support operations.

MEGA Utility Experience – Act 286 Reforms

There have been 11 final MPSC rate orders for the 7 rate regulated MEGA companies issued since Act 286 became effective in 2008. All but one of these were settlement cases and only 3 of the 11 cases (1 for We Energies and 2 for Indiana Michigan) included self-implemented rates. This is not unexpected because settlements frequently occur in the smaller utility cases. See accompanying slides. Indiana Michigan obtained the initial CON order under the new procedures for its Cook nuclear plant work associated with life extension. Deskewing has occurred in the rate cases although Act 286 allows a gradual phase-in for the MEGA utilities compared to the 5-years for Consumers Energy and DTE Electric. See MCL 460.11(5). The 12-month stop has not hindered regulatory review. Projected test years are generally used in rate filings since Act 286 became effective. The MPSC continues to exercise authority to scrutinize projected amounts.

Several points are worth noting:

- MEGA member utilities have not filed rate cases in rapid succession during the 5 years following the reforms of Act 286 effective in 2008.

- Self implementation is used infrequently by these utilities and the final orders in those cases followed quickly.

- The almost nonexistent level of retail choice activity continued for MEGA utilities after 2008, until the recent activity affecting UPPCO and Indiana Michigan.

Unintended Consequences – Part Two

The original promises of Michigan's restructuring program were captured in the phrase: "choice for those who want it and protection for those who need it", and in the goal to deliver lower electricity costs to customers. From MEGA's perspective, there are significant unintended consequences to consider:

- Few retail choice service offerings to customers of any class for 10 years.

- Michigan customers of all types paid for the implementation of restructuring, with few receiving even an opportunity for savings.

- The early California and Enron experiences gave rise to concerns over the functioning of deregulated energy markets.

- Many factors other than market structure are driving the cost of energy including fuel costs, transportation costs, EPA compliance costs, and costs to comply with new renewable and efficiency standards.

- The hybrid restructuring model has created a small class of customers receiving more favorable rates due to temporary wholesale market conditions.

- Some commercial and industrial customers and power marketers now lobbying to break the cap. Removal of the revenues from those customers would threaten harm to those who remain as utility customers, forced to absorb more of the generation fixed costs.

Factors Affecting Restructuring Reforms

Most of the MEGA utility service is in the Upper Peninsula, with a stable or declining population of approximately 320,000 spread over a large area. Economic growth opportunities are limited. The electric generation infrastructure includes older coal and hydroelectric plants. Electric service is divided among 4 investor-owned, 3 cooperative and 11 municipal utilities. We Energies has a unique situation with the Cliffs Natural Resources mines (exempted from 10% choice cap) constituting near 80% of total load with the Empire mine slated for shutdown by early 2015. Retail choice under the current model, if the cap is lifted, will be disruptive in this market area, assuming the AES targeting strategy continues.

In considering reform measures, members of this Committee are encouraged to discuss the regional issues with the Upper Peninsula House members to obtain a better understanding.

MEGA electric utilities Xcel, Indiana Michigan, We Energies and Wisconsin Public Service Corporation operate integrated systems over two states, with the major portion of their service in the adjoining states of Wisconsin or Indiana. Costs are allocated between states as allowed by their respective utility regulators. Wisconsin and Indiana are not restructured states. Therefore, cost recovery disruptions from a Michigan restructured market may affect system-wide allocations as determined in the neighboring jurisdiction.

None of the MEGA electric utilities obtained securitization of assets stranded due to restructuring, as previously noted. The issue of potential securitization will need to be revisited for these companies if the choice program is expanded and significant loss of revenue occurs.

In conclusion, MEGA appreciates the efforts by the legislature and administration to study these issues, which continue to be difficult. There are competing views by groups with legitimate interests from their perspective. Re-opening retail choice will call for detailed scrutiny of all pertinent issues affecting industry structure and operation of the markets.

Respectfully submitted,

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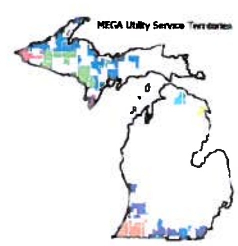
MEGA Background – Member Characteristics

Company	# of Customers	Service/Major Facilities	Regulation
Alpena Power	17,650	Electric only	MPSC
Aurora Gas	2,588	Gas only	Home Rule
Citizens Gas	17,143	Gas only	Home Rule
Indiana Michigan (AEP)	127,936	Electric only - multistate MI/IN Cook Nuclear Plant	MPSC
Michigan Gas Utilities (Integrys)	164,927	Gas only	MPSC
Northern States Power (Xcel Energy)	9,443 E 5,289 G	Electric and Gas - multistate MI/WI	MPSC
Upper Peninsula Power (Integrys)	51,970	Electric only UP Hydro	MPSC
We Energies	27,560	Electric only - multistate MI/WI (gas in WI) Presque Isle Coal Plant UP Hydro	MPSC
Wisconsin Public Service Corp (Integrys)	8,982 E 5,326 G	Electric and Gas - multistate MI/WI UP Hydro	MPSC
Total	438,744		

MEGA Utility Service Territories

- Xcel Energy (E,G)
- Upper Peninsula Power Company (E)
- We Energies (E)
- Wisconsin Public Service Corp (E,G)
- Alpena Power Company (E)
- Indiana Michigan Power Company (E)
- Michigan Gas Utilities (G)
- Aurora Gas Company (G)
- Citizens Gas Fuel Company (G)



Service areas shown are approximate and do not separately identify natural gas and electric areas for combination utilities. "E" means electric service offered; "G" means gas service.

MEGA – MPSC Rate Orders

U-16801 2-15-12	I&M Power (electric)	$24.5 million	$16 million	$14,644,416	10.2%	New depreciation rates due to TC settlements, 50/50 sharing of off system sales revenue
U-16417 12-20-11	UPPCO (electric)	$7.7 million	None	$4.2 million	10.20%	Settlement – included RDM [illegible]
U-16475 9-13-11	Xcel Energy (electric)	$1,074,015 million	None	$819,584	10.30%	Settlement – includes recovery of deferred choice implementation costs 4 step rate realignment plan (immediate 2% on R subsidy)
U-16166 12-21-10	UPPCO (electric)	$15.4 million	None	$8,868,706	10.3%	Settlement – End uncollectibles tracker, rate realignment plan, pilot RDM
U-16180 10-14-10	I&M Power (electric)	$62.5 million	$44.3 million	$35.707 million	10.35%	Settlement – 15 year rate realignment, choice surcharge
U-15981 10-14-10	WEPCO (electric)	$42.1 million	$12 million	$23,264,113	10.25%	Addressed excess capacity/used and useful for 2 new coal units plus sale/leaseback financing
U-15990 12-16-09	Michigan Gas Utilities (gas)	$8.44 million	None	$3.5 million	10.75%	Settlement – Includes uncollectibles tracking but decoupling issues will be litigated
U-15988 12-16-09	UPPCO (electric)	$12.182 million	None	$6,499,934	10.9%	Settlement – includes uncollectibles tracking and pilot decoupling using CE model, revised depreciation rates.

MEGA – MPSC Rate Orders

U-15935 10-14-09	Alpena Power Company (electric)	$2,101,878	None	$650,000	10.80%	Settlement
U-15549 1-13-09	Michigan Gas Utilities (gas)	$13.947 million	Requested interim no action	$6 million	10.45%	Settlement, proposed RDM in next case
U-15500 11-13-08	WEPCO (electric)	$21.976 million	Interim $8.4 million requested – later withdrawn	$7,249,185	10.55%	Settlement; included new plant lease payment
U-15352 12-4-07	WPSC (electric)	$804,335	None	$560,000	10.6%	Settlement
U-15250 6-12-07	Alpena Power Company (electric)	$1.745 million	None	$1.3 million	11%	Settlement – no new case until mid-2009
U-14943 6-27-06	UPPCO (electric)	$6.57 million	None	$3.81 million	10.75%	Settlement, $10.3 million [illegible] for annual O&M Silver Lake expense deferral

MEGA Utility Experience – 2008 PA 286

- No significant retail choice activity at the time
- No securitized stranded plants
- Inactivity continued until recently (I&M, UPPCo)
- Use of projected test year subject to MPSC review
- Cases often settle without self-implemented rates

Act 286 Reform – Considerations

- UP market characteristics: adequate capacity + low growth and population
- Multistate utilities with integrated systems (cost allocation)
- Concern over disruptive impacts of retail choice
- Encourage discussions with UP legislators